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PurchasingWorld®

THE BUYER'S MAGAZINE

JULY 1989

A TOUGH BALANCING ACT

1989 NAPM Conference highlights

Quality in steel transactions • Buyers zero in on transportation

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PurchasingWorld

29100 Aurora Road, Suite 200
Cleveland, OH 44139
Phone: 216-248-1125

Editorial Director
Paul V. Farrell, C.P.M.

Editor-in-Chief
Robert S. Reichard

Editorial Staff
Managing Editor
Ron Stevens
Senior Editor
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Publisher
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Sales & Marketing Coordinator
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by Robert S. Reichard, editor-in-chief

The worst is over

It's virtually unanimous. The worst of the recent price runup looks to be over. Increases will still be bothersome—with inflation continuing to run well above the levels of a few years back. But the rates of gain are projected to level off, and may be a bit lower by fall—a trend which is expected to continue into early 1990.

So say buyers, sellers, the econometric forecasting models, and *PurchasingWorld's* own economist Dr. Roger Williams—all of whom have contributed to *PW's* new midyear business outlook section featured in this issue. Behind much of the optimism: expectations of a "soft landing"—with slower (though still positive) rates of growth expected to ease a good deal of the upward supply-demand pressure that has been propelling prices up over the past year or so.

These actual projections tell the story:

- **Dr. Roger Williams:** the Moravian College professor of economics sees industrial producer price increases decelerating almost a full percentage point—from 6.1 this year to around 5.3% in 1990. One reason: increasing productivity which will hold the unit labor cost advance to only 2% next year.

Other economists would seem to agree. Thus the prestigious National Association of Business Economists, in its latest survey of 54 professional forecasters, puts the inflation rate (this time on a cost-of-living basis) at only 4.7%—again a significant 0.6 percentage points under this year's estimated 5.3% level.

- **Buyer projections:** two independent forecasts are presented—one by *PW* readers and the other by the NAPM Business Survey Committee. Both suggest a peaking out in the quarters immediately ahead. Particularly encouraging: only 14% of NAPM members surveyed expect across-the-board increases over the next six months—half the 28% figure noted at the beginning of the year when a similar question was posed. And the 4.5% average rise anticipated by *PW* readers for the year as a whole is actually a bit under the year-to-date pace.
- **Econometric models:** this year's projected advances are a bit high (4.7% for the GNP price deflator and 5.4% for producer finished goods). But both these indexes are targeted for deceleration—with the slowdown in the producer level leaving next year's advance at only 3.7%. A rundown of specific areas (by DRI) suggests a similar trend—with two out of every three product lines surveyed targeted for smaller-than-1989 advances over the next year.
- **Top management:** the picture is much the same here. The average increase (as estimated by corporate executives) is put at only % this year. That's not much different than the 3% increase estimated by these same people just six months earlier.

Why all this cautious optimism? The "soft landing" scenario, of course, is a major factor. But there are other reasons, too. For one, the pickup in the dollar would seem to indicate that runup in import prices is over—something which, in turn, should put some restraint on pricing options.

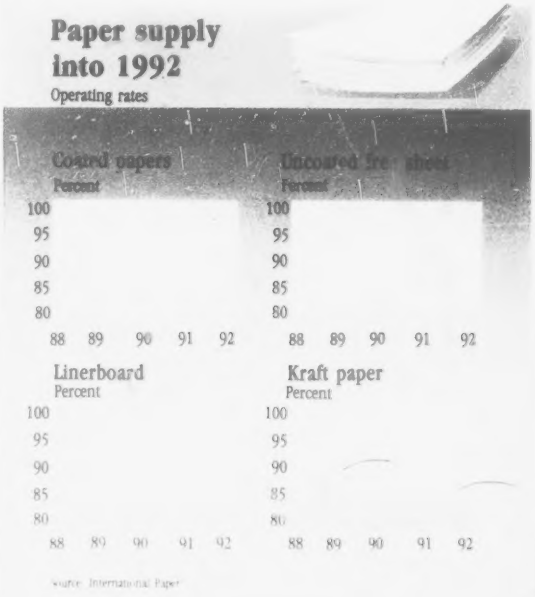
Then there's the expectations of a leveling in crude oil tags—as OPEC slowly increases its output. This can't be underestimated, for every dollar increase in crude almost immediately translates into a 0.2% percentage point increase in the cost of living.

A few words are also in order on increasing availability. The relatively small increase in industrial production suggested for 1990 is a lot lower than the expected increase in new production potential. If nothing else, it indicates that the rise in factory utilization rates is over—and that the rate could edge a point or two lower over the next 6-12 months.

And if more assurance is needed—even the usually cautious Fed is becoming somewhat more optimistic. One member, for example, says: "The conditions for a sustained surge in prices are just not there."

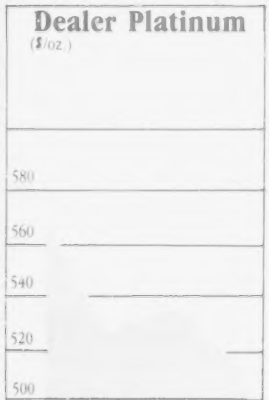
Paper pinch seems over

The worst of the paper and paperboard supply pinch seems over. If International Paper's current market projections are anywhere near correct, things should remain in fairly good balance—not only in 1990 but into 1991 and 1992 as well.



The new estimates, released in the firm's new "Direction 90" report, also confirm an American Paper Institute study of late last year which showed the industry upping its capacity sights.

- **Coated papers:** With the inflationary effect of stockpiling removed from end-user demand and an inventory draw-down underway, 1989 demand should equal 1988's. Capacity is up modestly; the only new machines being built won't significantly affect supply until 1990.
- **Uncoated free sheet:** Supply will increase slightly faster than demand in the next several years. Operating rates may dip to 90% in 1990 and remain there over the next few years. A number of new paper machines will come onstream between now and 1992. Imports are also expected to increase—up to 800,000 tons by 1994 as trade barriers fall away and the U.S. dollar strengthens.
- **Linerboard:** U.S. box shipments will set a new record for the fourth consecutive year, but they are projected to drop a bit in 1990, with recovery anticipated by 1991. This implies only a 92% operating rate in 1990 (*versus* 97% in 1988). But the rate should climb to 95% in 1992.
- **Kraft paper:** Demand loss (mostly from plastic substitutes) has been more than offset by the loss of supply. This should continue but at a much slower pace. Meantime, the biodegradability of paper should impact future demand positively. Result: operating rates should continue to back and fill in the 93-94% range through 1992.



Platinum demand stays strong

Prices should begin to strengthen after recent easiness—if only because global demand has been outpacing supply for four consecutive years—with the largest deficit (460,000 oz.) occurring last year (3.66 million oz. demand *versus* 3.2 million oz. production). In any event, demand continues to jump—rising 15% in 1987 and 10% last year; a reflection of increasing auto catalyst use. Best bet: a modest rise in quotes—perhaps into the $550/oz. range (dealer basis) by next year. But look for some respite within 3-4 years as new mines open up in South Africa, Canada and Australia.

Semiconductor drop continues

The price downtrend in DRAMs is likely to persist. Thus 256K types which

Continued...

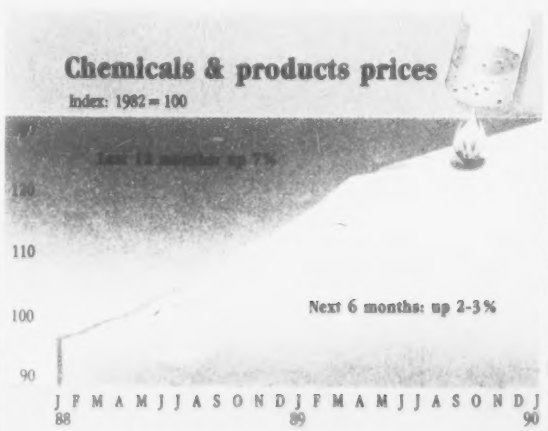
Chemical demand losing steam

CURRENT SITUATION: The big demand spurt of last year—when industry output racked up an eye-opening 8.5% advance—is running out of steam. True, production and sales increases are still being reported, but they're now running at only about half of last year's pace. And operating rates—although at the quite high 89% level—are now showing signs of leveling off. **Price increases also seem to be fewer and farther between.** And if you zero in on individual product lines, there's now a sprinkling of declines.

DEMAND: The recent slowing overall pattern is expected to persist into the second half. Upshot: Chemical output gains for the year as a whole are put at only 4-5% *vis a vis* 1988. Behind the deceleration: Some softness in both domestic and export markets. Better-than-average advances, however, are seen for synthetics (manmade fibers and plastic resins). Fertilizers, too, should do better than average. As for 1990, look for still more respite.

SUPPLY: Relief isn't that far off—as heavy capital spending translates into new capacity at a time when demand gains seem to be tailing off. This is probably most evident in plastic resins where the average operating rate is expected to fall four percentage points this year (to 87%). Big expansions are also underway in the petrochemical sector. For example, seven new "grass roots" ethylene plants have been announced.

PRICE OUTLOOK: Better market balance is already beginning to slow down the overall rate of increase—with advances over the next six months put only in the 2-3% range (4-6% at annual rate). While hardly Nirvana, it marks a continuation of the trend noted over the past few months. In any event, it's a lot better than the huge (10.6%) jump recorded over the 12-month period ending in March.


Chemicals & products prices
Index: 1982 = 100
Last 12 months: up 7%
120
110
100
90
Next 6 months: up 2-3%
J F M A M J J A S O N D J F M A M J J A S O N D J
88
89
90

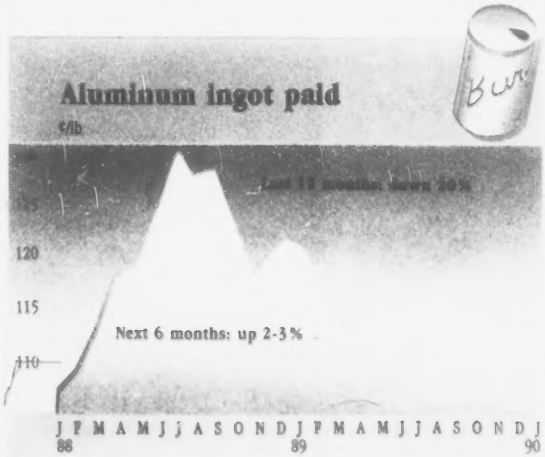
Aluminum

CURRENT SITUATION: The light metal has retreated from its recent peaks. Behind the softening: Some build-up in user inventories, slowly increasing global output, and concern about a general economic slowdown. Not surprisingly, ingot now fetches just under $1/lb.—well below the $1.30/lb. high of last year. Also indicative of a leveling off: Producers are holding aluminum rigid container sheet unchanged through the third quarter and ingot unchanged through July.

DEMAND: The industry seems headed for its third straight year of gain. Leading the uptrend will be packaging, exports and aircraft/aerospace. True, the latter accounts for only about 3% of tonnage. But in dollar terms it's a lot larger than that. Construction, meantime, looks to be off. But that won't be enough to prevent about **a 2% increase in aggregate domestic shipments (ingot and mill products)—to 17.3 billion pounds.**

SUPPLY: The recent tightness has eased a bit—and is being reflected by somewhat lower prices, a 5% increase in year-to-date domestic production, and a 2% increase in global stocks *vis a vis* a year ago. And over the longer pull, some new expansions have been announced in such diverse areas as Canada, China, Venezuela, Brazil, and the Mideast. But the figures only add up to about two million metric tons (to 17.25 million by 1995 *versus* 15.25 million last year).

PRICE OUTLOOK: Ingot could continue to inch lower—if, as expected, overall demand begins to decelerate. Producers too, have some leeway to cut—for average production costs are now estimated to be down near the 55¢/lb. mark—off 10¢/lb. from levels prevailing just a few years ago. But don't expect prices to drop all that much.



Lead prices still up

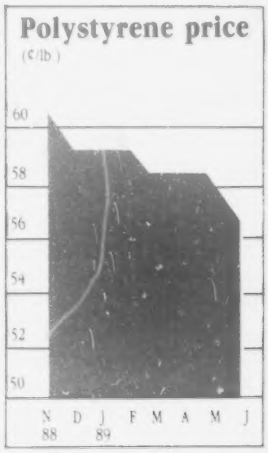
The heavy metal has been confounding the experts—with new advances bringing the going producer price up into the upper 30s—some 3¢/lb. above recent lows. Behind the runup: Healthy demand from both the ammunition and battery sectors. On the latter score, manufacturers are said to be rebuilding their stocks of replacement batteries which are off nearly 30% from year-ago levels. Another factor behind current strength: tight secondary supplies. Look for some softening by July when battery demand takes its traditional summer breather.

Computer price drops continue

The downtrend continues. Latest moves include a decision on the part of Data General to cut prices by as much as 25% on some versions of its MV/15000 mid-range line. And in the workstation area, Sun Microsystems has slashed tags 10-15% on its 386-based line—in a move to make these machines more competitive with high-end 386-based PCs. Also in the workstation area—Solbourne has reduced its Series 4600 models by 17%—saying that it would keep prices 10% lower than Sun's.

Polystyrene prices drop

As much as 3¢/lb. has been shaved off the going price—bringing transaction tags for the general purpose/crystal grade down to 56-57¢/lb. The impact grade is off by a similar amount (to 58-59¢/lb.). One factor behind the weakness: an expected 10% jump in new production potential this year on top of last year's 6% increase. Upshot: operating rates are likely to continue dropping—from 89% and 87% in 1987 and 1988, respectively—to around 82% this year.



Steel demand, prices down

The long price runup is over. Sign of the times: Hot-rolled sheet tags are being discounted anywhere from $35-80/ton—because of both heavy supply and modest user inventory cuts. And transaction prices on prime electro-galvanized sheets have dropped about 5% in recent months. Another good omen for buyers: steelmakers were able to extract less than a 2% increase from GM for 1990 model cars. GM—in an effort to keep steel tags down—also continues to develop programs of buying metal for some of its suppliers.

New transport service debuts

An alternative for those who find overnight delivery too slow: next flight out (NFO) service. True, it's costly—a 20-pound package via NFO would probably come to $150 when everything is added up (*versus* only about $50 for overnight delivery). Nevertheless, it must have something to offer—given growth rates that are currently put in the 4-5% annual range. Biggest users: high-tech firms in the electronics, computer, and medical equipment fields.

Benzene oversupply tumbles prices

Credit an oversupply of aromatics for the current price tumble. Demand hasn't been all that robust, either—as key end-use markets (styrene monomer and phenol) take a breather. In any case, inventories at latest count were running better than 20% ahead of a year ago. Not surprising, prices on the spot market have slipped to near $1.20/gallon—a far cry from the $1.75/gallon contract posting in effect at the beginning of 1989. More important, prices should stay weak near term.

Most fertilizer tags down

Excess production and high dealer inventories have made for a sharp drop in diammonium phosphate (DAP). Prices at latest report were down to $15¢/ton (FOB Florida)—off $25/ton from recent February highs. Amonia and urea tags are also off. Ammonia, for example, dropped to $103-105/ton (Gulf basis)—off $25-35/ton from February.

Energy outlook optimistic

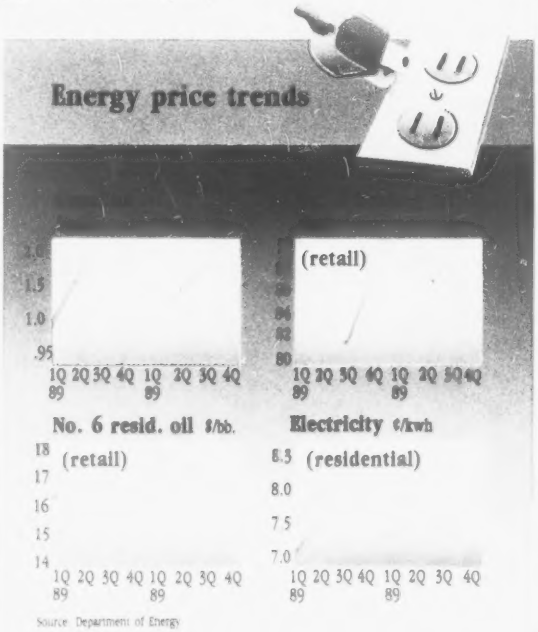
Government energy analysts remain basically optimistic—despite the recent price runups in both crude oil and refined products.

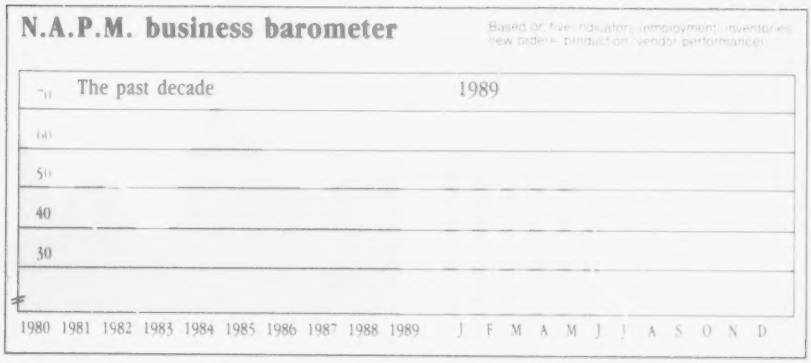
They see the bellwether imported crude tag most likely holding in the $17/barrel range through 1989 and much of 1990.

And these DOE experts could be right. Reason: Several OPEC producers are calling for an increase in the cartel's production—from the official 18.5 million barrels/day.

Meantime, here's a more detailed price rundown on what analysts see ahead into 1990:

- **Gasoline:** Prices have been rising sharply as recent world oil price boosts are passed along and the market is affected by various concerns regarding the ability of refiners to meed Reid Vapor Pressure rules by 1990.
- **Heating oil:** Retail averages will be up 3¢/gallon (to 84¢) this year—with a similar increase to 87¢/gallon projected for 1990.
- **Resid fuel:** This year's relatively big average retail jump—15% (to an estimated $16.22/barrel)—won't be repeated in 1990.
- **Natural gas:** Wellhead prices should rise about 3% over each of the next two years. Last year's seasonality (caused by big temperature extremes) should be dampened if, as expected, we return to more normal weather patterns.
- **Electricity (residential):** Some modest upward pressure is anticipated for 1990 after recent relative stability. The average, for example, is put at 7.88¢/kilowatthour (up 4% from last year).




N.A.P.M. business barometer
Based on five indicators (employment, inventories, new orders, production, vendor performance)
The past decade
1989
70
60
50
40
30
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989
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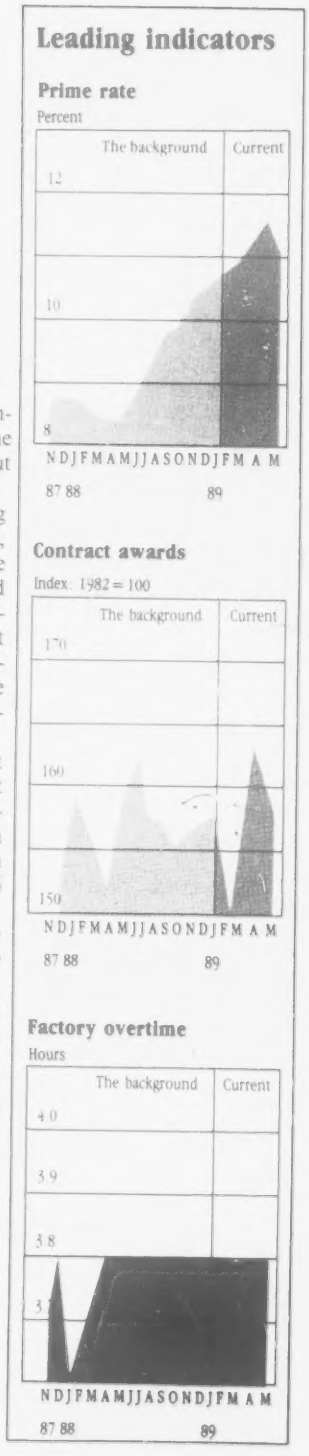


KEY ECONOMIC TRENDS

NAPM barometer drops

A lower rate of growth now seems almost certain for the next few quarters.

One good sign: the widely monitored NAPM business barometer dropped under the neutral 50 mark last month (see chart), the first time this has happened in over three years.

True, one month doesn't make a trend. But it does suggest that change is in the air. As NAPM Business Survey Chairman Robert J. Bretz puts it: "Virtually all indicators confirm the slowing of the economy and, perhaps more importantly, the sharp slowing of inflation growth along with it."

The latter is particularly encouraging. Not only does it back up *PW's* mid-year price projections in this issue, but it also should make the "soft landing" forecast a lot easier to achieve. Other evidence supporting the hoped-for deceleration: relatively small gains in retail sales, industrial production and employment—and actual declines in construction and auto sales.

But deceleration should not be confused with recession. The latter is still ruled out by rising disposable income, fairly high consumer confidence, trim inventory levels, improved installment debt, rising exports, and (last but not least), a peaking out in interest charges.

The prime rate, for example, has declined for the first time in over a year (top chart, right). Other things being equal, this is likely to spill over into reduced rates on a broad range of business and consumer loans—thereby helping to keep the economy on a relatively even keel.

The drop in the prime is also likely to have some braking effect on the recent housing slump where new home sales for the year have been running close to 5% under comparable 1988 levels. Point to keep in mind: many banks use the prime rate as a base for calculating rates on adjustable rate instruments such as home mortgage loans.

The need for some bolstering here is also evidenced by the fact that overall construction spending is down for the year—and the same is true of contract awards, which for the year-to-date are off about 2%.

Consumer buying of big ticket durables, meantime, also leaves something to be desired. Autos are a good example: May sales of domestic-made vehicles ran at a mediocre 7.2 million annual pace—down from the 7.5 million level of the previous month.

To be sure, these are not horrendous figures. But they do indicate that consumers will at best be only a neutral factor in the growth equation over the next 3-6 months.

This less-than-positive picture also shows up in the latest consumer surveys. The Conference Board's Confidence Index is now a bit under late winter highs—and expectations as to the purchase of new cars don't compare all that favorably with last year's readings. On the other hand, it should be emphasized that both these measures are still at respectable levels—nowhere near recession lows.

Last but not least, a less ebullient outlook is indicated by latest factory overtime figures. Excess work hours have slipped—sug-

gesting less urgency in meeting production schedules.

What does it all add up to? *PW* estimates for industrial production put second half gains at only 1% at annual rate—a far cry from the 3.5% rate reported as recently as the first quarter.

But that's all to the good. Judging from recent pronouncements that's just about the rate of growth wanted by the Fed and most administration economists.

CURRENT PRICES

Energy, autos push prices

Uncle Sam's bellwether industrial producer price index edged up a disturbing 0.6% this past month—or more than 7% at annual rate.

But most government inflation watchers are not too concerned. They note that two special factors were at work—sharply rising energy prices and higher car costs occasioned by reduced auto company sales incentives.

Neither of these two factors is expected to be repeated anytime soon. On the energy front, the big 2.7% monthly rise is expected to give way to stabilization or even some modest declines as crude oil begins to show signs of peaking out.

Another sign that the worst of the runup may be over: Crude nonfood (less energy) totals actually showed a fractional decline at latest report. Since these are basically demand-sensitive items, it does seem to suggest that market pressures at the grass roots level are starting to ease up a bit.

This easing shows up clearest in the metals sector where copper, aluminum, zinc, nickel and most nonferrous mill shapes all fell. Stainless steel also edged lower. Ditto, the overall finished steel product average.

The same encouraging trend is noted in the chemical and allied product area. True, both inorganic and organic averages moved higher. But the gains were both less than 2.5% at annual rate (well under recent advances—see *PW Predicts* chemicals).

Then, too, plastic resins, which apparently peaked earlier this year, continue to fall—with a 0.9% (or nearly 11% at annual rate) drop recorded last month. And judging from current reports, the same trend is continuing into early summer.

On a less rosy note was the 0.4% (or 4.8% at annual rate) advance in capital goods. But much of this can be traced to the increases in autos alluded to above—an area that Uncle Sam counts as part of capital goods.

In any case, the capital goods picture (ex autos) is not all that bad. True, a fair number of products rose—including office equipment, material handling equipment, transformers, paper industry machinery and textile machinery.

But all these have to be weighed against the nearly "no change" headings noted for rail equipment, metal forming machine tools, aircraft and mining machinery—all of which rose substantially during the previous month.

Adhesive industry clings to progress

Slow demand growth, a lot of innovations and new applications and modest price advances; that's the scenario painted for the near-10 billion pound adhesive industry over the next few years.

The analysis, just released by Cleveland's Freedonia Group, points to about a 4.3% average annual price increase (unit cost—cents/pound basis) over the next five years. Subtract that from the projected 6.8% annual dollar growth projection—and real demand looks to be advancing at only a 2.5% rate.

On the changing product mix—the study sees substitution of higher performance, more efficient adhesives. In any case, research will center on decreasing cure times, developing more efficient applications systems and formulating products that comply with stricter government rules.

Viewed from a type of adhesive perspective, the relatively small (6% of the market) "new synthetics" types will grow fastest (4.8% in real terms through 1993)—despite the fact that these are the most expensive. Many of these are aimed at replacing mechanical fasteners—and their continued penetration into these new markets account for high growth rates.

On the other hand, "early synthetics", which will continue to comprise over half of the market, are projected to grow 2.7% annually in real terms. Phenolic and vinyl types will remain dominant, but best opportunities are seen in hot melt adhesives—due to their rapid cure, long shelf life, absence of solvents, and amenability to automated production lines.

As for "natural" adhesives, these will only grow slowly due to market maturity and lack of new product applications. Nevertheless, they will still comprise over 40% of the market in 1993 because of their low cost and adaptability to high-speed machinery.

A few words on end-use markets: Packaging is largest—accounting for about 49% of total demand. Growth for wood product adhesives (the second largest user) will result from renewed activity in

the construction sector and more demand for wood products. But the greatest opportunities are anticipated in industrial bonding applications where annual gains of 2.7% are projected.

PROCUREMENT STATUS REPORT

Soft landing implications

The "soft landing" scenario projected for the economy has some positive implications for procurement. Other things being equal, slower growth means more bargaining leverage, improved availability and a slow shrinkage in leadtimes.

Some of these trends may already be discernible. On the leadtime front, *PW*'s exclusive leadtime index actually fell fractionally under the neutral 50 mark last month—meaning that there are now more items coming in than there are stretching out.

This same trend shows up in the NAPM Business Survey Committee report. For the first time in years, buyers reporting faster deliveries outnumber those noting slowdowns—though the difference (as in the case of *PW*'s leadtime index) is slim.

In any event, the survey's delivery index (where anything under 50 measures improvement) fell to the lowest level in almost three and half years. Equally meaningful: the number of commodities reported in short supply declined to 12—the fewest since November, 1987.

Not surprising, the number of purchasing managers committing 90 days or more in advance for production materials remains at the lowest level in years—18% now *versus* 24% as recently as February.

These figures are also consistent with inventory retrenchment, where the number reporting lower stocks (25%) far outweighs the 14% still adding. As the NAPM puts it, "Purchasing people appear to be more confident about material shortages disappearing—as they face the usual summer slowdown in activity."

But perhaps the most optimistic sign of a waning sellers' market is the survey's findings on prices. True, increases (reported by 25%) still outnumber decreases (10%). But the gap between the two is half the 38 percentage point figure of just one month earlier.

Also worth noting: only 11 items were reported up in price at last report—the fewest in nearly two and a half years. And that was almost matched by the 10 items reported to be edging lower.

Operating rates ease down

The worst of the recent supply pinch may be over—witness the leveling off and even slight downturn noted in the overall factory utilization rate over the past few months (see chart).

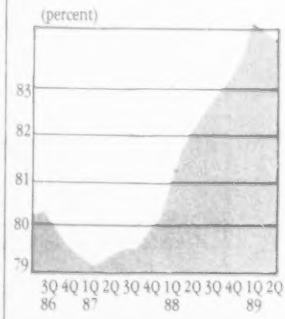
Credit the shift to two factors: A somewhat slower industrial production growth pattern and a faster rate of increase in new capacity.

And these trends are likely to continue. Most forecasts call for industrial production to advance at a 1-2% annual rate in the second half—as auto and construction demand take a breather. On the other hand, new potential which has been coming onstream at a 3% rate should hold at this pace—and may even accelerate a bit as capital spending gains continue.

You can probably figure on another 0.5-1% decline in the average operating rate by year end—enough to push this key barometer of availability down into the 83% range. Point to keep in mind: that's two

Operating rates have peaked

The overall trend



Industry-by-industry

(% point change from year earlier)

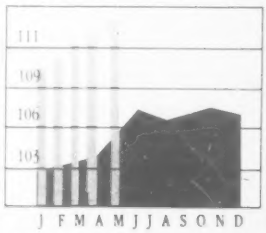
Primary metals	+1.9
Fabricated metal products	+1.3
Non-elect mchy	+4.9
Elect. mchy.	−0.1
Automotive	+4.2
Instruments	+2.3
Tectile mill products	−0.5
Paper & prod.	−1.9
Chemicals & prod.	+2.6
Petroleum prod.	−2.0
Rubber & plastics	−3.4
Utilities	+0.4

Industrial prices

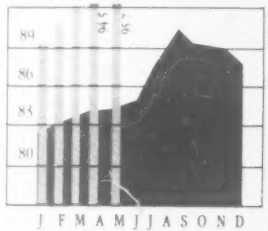
(Index 1982 = 100)

1988 ● ● 1989

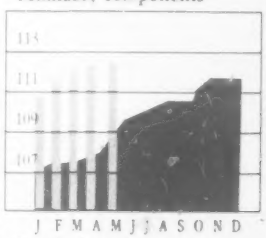
All items



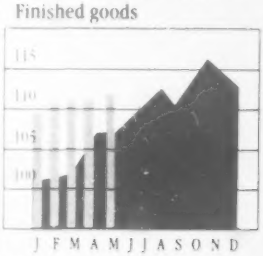
Raw materials



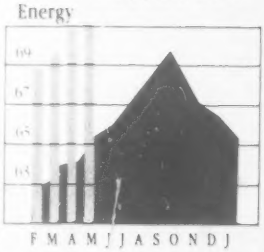
Semifabs. components



Finished goods



Energy



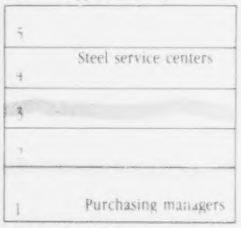
Source: Bureau of Labor Statistics

Steel

Operating rates

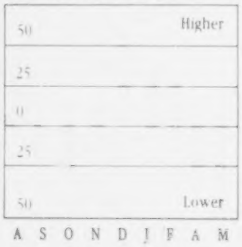
Inventories

(Months supply on hand)

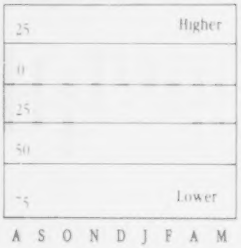


Demand (STEEL SERVICE CENTERS)

(Percent of respondents)



Demand (STEEL BUYERS)



Source: Steel Service Center Institute
NAPM Steel Buyers Committee

significant percentage points under the 85% level which has traditionally signalled shortages and all the problems such shortages bring.

This is not to say, of course, that all industries will be equally affected. Paper rates, for example, remain above the 92% range. And chemicals are approaching the 90% level. There has also been a five percentage point jump in non-electrical machinery rates over the past year.

But many of these areas seem as high as they're likely to go. New paper production is on the way (see PW Predicts section). And the same is true of chemicals and plastics—with some excess production now actually cropping up in the latter area.

Metal availability is also looking better. That's probably why there has been some recent weakening in steel, copper, aluminum and nickel tags in recent weeks.

On the other hand, don't expect any return to the all-out buyers' market of a few years back when operating rates were running well under 86%. As of now, all signs point to about an 82-84% factory utilization rate—a level consistent with basic supply-demand balance rather than glut.

Import prices

(compared to domestic)

Steel buyers

ABOVE 59%
SAME 19%
SLIGHTLY BELOW 22%
SUBSTANTIALLY BELOW %

SERVICE CENTERS (carbon)

ABOVE 4%
SAME 86%
5-10% BELOW 10%
10-20% BELOW 0%
OVER 20% BELOW 0%

STEEL SCENE

Steel demand declines

Don't be surprised to see a sharp decline in steel demand over the next few months.

New survey figures from both buyers and service centers tell the story. On the buyer front, for example, an impressive 39% of those queried are talking about reduced purchases over the summer months—with only 4% contemplating additions. This big 35 percentage point gap compares to a 17 point gap last month and the even smaller 6 point differential the month before.

The latest Steel Service Center Institute (SSCI) study is even more lopsided on demand estimates. Specifically, 52% see declines—the largest such reading in nearly three years. And again this overwhelms a minuscule 4% who are still hopeful of increases.

Part of this represents expectations of a leveling off in consumption—particularly by such large steel-using sectors as autos and construction.

But inventory retrenchment looks to be another significant factor. An impressive 68% of queried service centers say their inventories are too high relative to sales—again the biggest such number in several years.

Commenting on this, SSCI President Andrew G. Sharkey observes, "The overall upward trend in total steel inventory is some cause for concern. But it is encouraging that our members will be attempting to reduce total inventory levels in the months ahead."

Buyers, too, are becoming concerned about their holdings. And with good reason, for their months' supply showed a fairly large jump at latest report—all the way up to a 2.13 month level (*versus* only 1.81 the previous month).

They are also contemplating retrenchment—as witnessed by the fact that 68% now say they will be cutting back over the next six months. Contrast that to no respondents planning on making additions—and it's clear that buyers mean business.

The overall impact of this inventory swing is estimated at over two million tons by Wharton Econometrics. Specifically, a 0.5 million rise in stock levels over the first half is expected to give way to a 1.6 million ton second half cutback.

This change—plus a leveling off in consumption—is already having some impact on the availability front—as measured by buyer perception of shortages over the next six months. Right now, 78% of those queried see no problems—more than twice the 34-35% problem-free reading of this past spring.

Even fears about coated sheet—a product that 25% were concerned over a few months back—are diminishing. At latest report, only 7% felt this product line could be tight over the coming months.

Improving availability is also raising hopes about holding the price line over the remainder of the year. The aforementioned Wharton analysis actually sees

some erosion (composite contract and spot price basis)—with 3.5% knocked off midyear averages by year end.

Steel service centers are also becoming more optimistic about prices. Thus 26% of those queried see declines over the next six months, compared to only 15% who anticipate some overall advance.

You'd have to go back years to see more service centers opting for declines. It's also a major reversal from just a year ago when those contemplating increases (64%) overwhelmed a small 7% hoping for price breaks.

This month's breakdown

Index 1982 = 100

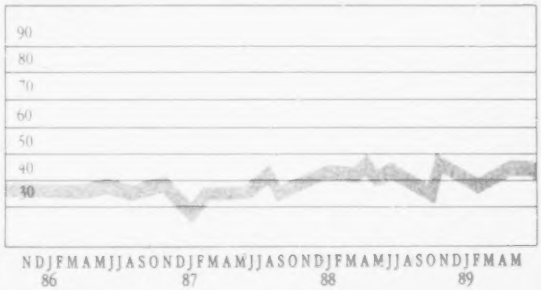
	Latest level (May)	% change from: Month ago	Year ago
Bearings	124.7	−0.8	12.7
Bolts, nuts, etc.	110.7	1.5	3.8
Chemicals, inorganic	107.9	0.2	7.6
Chemicals, organic	121.1	0.2	15.3
Concrete products	110.8	0.0	0.8
Corrugated cartons	113.1	0.9	2.4
Cutting tools, small	109.8	0.2	2.6
Electric lamps (bulbs)	124.0	0.0	−1.6
Electronic components	119.5	0.2	1.8
Fans and blowers	117.7	0.3	4.4
Foundry and forge products	114.3	0.3	5.0
Fuel oil (residual)	49.4	4.4	16.0
Furniture, commercial	128.4	0.6	3.7
Gasoline	76.9	8.9	29.0
Glass, flat	111.0	0.9	1.2
Glass containers	116.1	−0.2	3.6
Gypsum products	110.6	1.7	−1.9
Hand tools	127.2	0.2	5.6
Hand tools, power driven	115.9	−0.1	3.9
Industrial furnaces	124.0	0.6	4.1
Integrating and measuring instruments	118.1	0.8	1.7
Internal combustion engines	113.5	0.3	2.3
Lubricating oil	106.8	−0.6	2.5
Lumber millwork	128.0	0.4	5.3
Material handling equipment	111.3	0.7	3.9
Metal containers	110.5	0.3	0.1
Metal mill shapes (nonferrous)	138.7	−1.4	8.9
Metal tanks	111.6	1.3	6.8
Motors and generators	128.0	0.2	6.6
Motor trucks	129.0	0.2	4.1
Office and store equipment	108.7	0.1	2.6
Paperboard	143.5	−0.2	7.6
Paper boxes and shipping containers	129.9	0.8	5.3
Paper office supplies	122.2	0.8	7.4
Paint	118.9	0.4	7.0
Plastic resins	140.0	−0.9	7.6
Precision measuring tools	125.5	0.2	3.4
Pumps and compressors	114.6	0.4	6.2
Refractories	119.7	0.1	5.3
Rubber belts and belting	112.4	−0.5	6.4
Scales and balances	106.2	0.0	0.9
Steel products	114.7	−0.2	3.8
Switchgear	118.9	0.5	5.2
Textiles, synthetic fibers	104.7	0.7	7.9
Textiles, gray fabrics	113.9	−0.2	−0.3
Tires and tubes	98.0	0.9	4.8
Transformers and power regulators	116.1	0.7	7.7
Welding equipment	122.3	0.0	5.1
Wire and cable	148.0	0.5	21.1

NAPM procurement trends

(seasonally adjusted diffusion indexes)

An index where 50 is defined as the neutral level. to the extent a reading is above 50, it represents an expansionary tendency. More particularly, rising inventory prices, and new orders are seen as positive signs of economic growth. A trend toward slower deliveries is similarly interpreted.

Inventories



Speed of delivery

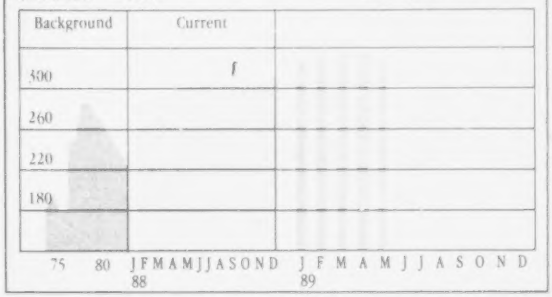
Prices

New orders

Raw material price barometer

(Index 1967 = 100)

Last month 331.5
Month before 335.0
Year ago 301.6



Latest spot market prices

	Latest price	Previous month	Year ago
FERROUS METALS			
Pig iron, basic, valley, gross ton	213.00	213.00	213.00
Pig iron, Bessemer, Pitts., gross ton	213.00	213.00	213.00
Steel, billets, Pitts., net ton	367.00	367.00	367.00
Steel, structural shapes, Pitts., cwt.	23.90	23.90	23.90
Steel, structural shapes, Chi., cwt.	23.90	23.90	23.90
Steel, structural shapes, Los Angeles, cwt.	23.90	23.90	23.90
Steel, bars, dlvd. Phila., cwt., merchant quality	18.70	18.70	16.50
Steel, bars, Pitts., cwt.	18.70	18.70	16.50
Steel, bars, C.R., Pitts., cwt.	25.20	25.20	19.45
Steel, plates, Pitts., cwt.	23.25	23.25	19.75
Steel, plates, H.R., Pitts., cwt.	23.25	23.25	19.75
Steel, sheets, C.R., Detroit, cwt.	29.65	29.65	28.15
Steel, strip, C.R., Chi., cwt.	36.18	36.18	36.18
Steel, basic wire, Pitts., cwt.	23.65	23.65	23.65
NONFERROUS METALS			
Aluminum, ingot, lb. (market place)	.93	.99	1.26
Antimony, N.Y., dealer, lb.	.95	.95	.98
Beryllium-copper, cost ingot, lb.	5.90	5.90	5.90
Brass, red, 85%, [sheet], lb.	1.81	2.02	1.80
Brass, yellow, [sheet], lb.	1.77	1.98	1.75
Cadmium, N.Y., dealer, lb.	6.80	7.10	8.00
Copper, electrolytic, wire bars, refd., lb.	1.18	1.39	1.16
Copper sheet, over 24 in., lb.	1.90	2.11	1.88
Lead, common, N.Y., lb.	.36	.36	.36
Magnesium, pig ingot, [99.8%], lb.	1.63	1.63	1.58
Mercury, 20 fl. lots, N.Y., fl.	295.00	295.00	355.00
Molybdenum, oxide, dealer, lb.	3.70	3.65	3.50
Nickel, cathode, dealer, lb.	5.65	6.50	7.05
Platinum, dealer, oz.	496.00	534.00	574.00
Silver, N.Y., oz.	5.21	5.64	7.01
Tin, N.Y., dealer, lb.	4.64	4.85	3.31
Zinc, Prime West, East St. Louis, lb.	.85	.85	.63
Zinc, die casting alloy, No. 3, lb.	.930	.930	.675
PAPER			
Uncoated book #3 offset, ton	1020.00	1020.00	920.00
Watermarked bond, ton	1095.00	1095.00	1070.00
Gummed sealing tape, carton	18.68	19.05	17.57
Grocery sacks, ton	495.00	495.00	455.00
Solid bleached paperboard, ton	780.00	780.00	685.00
Kraft linerboard, 42 lb., unbleached, ton	410.00	410.00	410.00
TEXTILES			
Burlap, 10 oz., 40", N.Y., yd.	.282	.282	.285
Cotton drill, 1.85, 59", 68x49, N.Y., yd.	1.22	1.22	1.22
Cotton middling, 1", N.Y., lb.	.611	.634	.644
Printcloth, 48", 80x80, N.Y., spot, yd.	.500	.500	.490
Army duck, 37", 13 oz., yd.	1.40	1.40	1.51
Blended printcloth, 64", 78x54, yd.	.775	.765	.640
20s combed yarns	1.85	1.85	2.00
Wool 64s, Staple, lb.	3.75	3.75	4.50

	Latest price	Previous month	Year ago
CHEMICALS			
Acrylonitrile, tanks, lb.	.400	.400	.395
Ammonia, anhydrous, tankcars, Gulf Coast, ton	103.00	123.00	100.00
Benzene, petroleum, tanks, Houston, gal.	1.22	1.49	1.05
Caustic soda, 76% solid, drums, carlots, cwt.	28.00	28.00	26.00
Cresylic acid [over 25%], tanks, lb.	.55	.55	.55
Formaldehyde, USP, 37%, [12% to 15% meth.], tanks, lb.	.106	.106	.106
Glycerine, synthetic, tanks, lb.	.845	.785	.685
Methanol, syn., tanks, 4,000 gals., f.o.b. Gulf Coast plants	.49	.52	.55
Naphthalene, crude, tanks, lb.	.16	.16	.22
Phthalic anhydride, tanks, lb.	.41	.41	.34
Polyethylene resin, low density liner film grade (market place), lb.	.465	.480	.465
Polypropylene, homopolymer grade (market price), lb.	.450	.450	.390
Polystyrene, general purpose grade (market price), lb.	.565	.585	.590
Polyvinyl chloride, pipe grade (market price), lb.	.415	.430	.420
Soda ash, 58%, light carlots, cwt.	6.15	6.15	6.15
Styrene monomer, 99.6%, tanks, lb.	.47	.49	.45
Sulfur, crude, ex-terminal Tampa, Fla., lt.	142.00	142.00	127.50
Sulfuric acid, 66%, commercial, tanks, ton	66.86	66.86	66.86
Titanium dioxide, anatase, reg., carlots lb.	1.020	.950	.870
Xylene tanks, gal.	1.45	1.45	.87
BUILDING MATERIALS			
Lumber, 2x4 fir, mbf, cl	328.56	329.50	329.30
Lumber 2x2 pine, mbf, cl	317.14	316.50	326.15
Plywood, plyform, ¾", msf, cl	602.66	592.28	578.70
Plywood, ¾", msf, cl	361.53	362.94	413.45
Cement, bulk, ton, tl	63.14	63.97	65.02
Sand, ton, cl	7.12	7.12	7.32
Ready-mix concrete, 3,000 psi/cu. yd., 15 cu. yd.	48.52	48.81	49.10
Crushed stone, 1½", ton, cl	N.A.	N.A.	N.A.
Concrete blocks, sand/gravel, 8"x8"x16", per hundred	89.10	89.10	N.A.
Reinforcing bars, whse base, per cwt.	22.79	22.64	20.72
Asphalt paving AC-20	109.36	108.53	128.37
Vitr. Clay Sewer Pipe, Prem Joint, 12", per ft, cl	N.A.	N.A.	N.A.
Concrete sewer pipe, 24", prem. joint, per foot, cl	17.89	18.14	N.A.
FUELS			
Crude oil (W. Tex Int Cush), bbl.	20.50	20.05	17.25
Diesel (reseller rack, Chi), gal.	.4950	.5325	.4625
Fuel oil No. 2 (N.Y.), gal.	.5290	.5162	.4675
Fuel oil No. 2 (Gulf spot), gal.	.4875	.4720	.4150
Fuel oil No. 6 (N.Y.) contract cargo, bbl.	20.00	21.75	16.00
Gasoline (reg lded NY), gal.	.7080	.7000	.5350
Gasoline (reg unlded NY), gal.	.6955	.6875	.5075
Kerosene (reseller rack, Chi), gal.	.5775	.6130	.5050
Propane (Mt. Belvieu, Tex), gal.	.2013	.2050	.2413
SCRAP MATERIALS			
Steel, No. 1, hvy., dlvd., Pitts., ton	110.00	114.00	104.00
Steel, No. 1 hvy., dlvd., Chi., ton	113.00	113.00	108.00
Copper, No. 1, East, wholesale buy, dlvd., lb.	1.040	1.125	.970
Copper, No. 2, East, wholesale buy, dlvd., lb.	.945	1.025	.880
Brass, red, East, wholesale buy, dlvd., lb.	1.000	1.085	.930
Brass, yellow, East, wholesale buy, dlvd., lb.	.575	.620	.425
Alum., old sheet/cast, E., wholesale buy, dlvd., lb.	.635	.655	.680
Alum., mixed clip, E., wholesale buy, dlvd., lb.	.715	.735	.750
Zinc, old, East, wholesale buy, dlvd., lb.	.38	.38	.24
Lead, clean solids, East, wholesale buy, dlvd., lb.	.22	.21	.22
Paper, No. 1 mixed, dlr., N.Y., ton	Nom.	Nom.	Nom.
Paper, old corrug. box, dlr., Chi., ton	Nom.	Nom.	15.00
Paper, old corrug. box, dlr., N.Y., ton	Nom.	Nom.	5.00
Old newspapers, Chi., ton	Nom.	5.00	15.00
Old white ledger, Chi., ton	75.00	75.00	75.00

[Sources: Metals Week, American Metal Market, Engineering News-Record (20-city averages), The Wall Street Journal, Journal of Commerce, Chemical Marketing Reporter.]

Price curve flattens

The projected flattening out in the overall price curve over the next year or so should be affecting a lot of individual products.

Lest there be any doubt on this score, take a look at the latest DRI price forecasts detailed in the accompanying table. Analysts at this econometric consulting firm indicate that roughly two out of every three product lines contained in the table will show smaller price increases in 1990 than 1989. And, while not shown in the table, this moderating trend is expected to continue into 1991.

Part of the improved outlook can be traced to expectations of less robust demand gains. Thus real GNP is projected to grow only 2.6% this year, with an even lower 1.4% advance targeted for 1990. Even in 1991, the real increase is only put at just over 3%.

Unit labor costs are also expected to contribute to somewhat lower price boosts. Aided by increasing productivity, for example, unit labor cost gains are expected to decelerate—from 4.8% in 1989 to 4.4% in 1990, and to an even smaller 3.7% in 1991.

With all the above in mind, here's how the DRI Cost Information Services group sees individual product line prices moving over the next few years:

● **Crude oil:** The price of foreign crude (refiner acquisition basis) is projected to post a 14.6% increase in 1989—mostly on the strength of a 152.9% annualized increase in 1Q. It suggests a year end price of $17.12/bbl., after averaging out at only $14.71/bbl. in 1988. On a rosier note, price escalation in crude is expected to slow in 1990-91—to increases of 5.7% and 6.2%, respectively.

As might be expected, refined petroleum products' tags will also be rising. Fuel oil prices will be up 6.0% in 1989, 7.1% in 1990 and 5.8% in 1991. Gasoline will follow a slightly different pattern. After a 1988 increase of just 0.8%, 1989 pumps tags jump 9.0%—with advances of 6.9% and 3.5% forecast for 1990 and 1991, respectively.

● **Machinery and equipment:** Reflecting the very strong demand conditions of 1988 which have trickled into early 1989, prices here are expected to increase 4.4% this year—up from only 1.5% and 2.6% in 1987 and 1988, respectively. But with some growth deceleration ahead, producers will be forced to keep price increases moderate in 1990—though by 1991 a business pickup should permit them more room to maneuver. In any case, the overall index slows to a 4.2% increase in 1990 before accelerating to 4.8% in 1991.

● **Electronic components:** Only computers, of the four major industries that use components, (the other three are communications, defense and automotive) will remain in the plus column near term. Upshot: output will slow and put a lid on price increases, too. Best bet: an increase of 3.7% in 1989, followed by only a 3.2% advance in 1990. But some acceleration to a 5.3% average rate of increase is contemplated for 1991.

There is one caveat—prices for individual items may vary greatly from the overall rates just given—with some prices falling dramatically while others remain steady. An example is that, with production of 1Mb DRAMs expected to jump by as much as 270% from 1988-89, prices for this component are expected to fall sharply. But as output shifts toward this increasingly popular DRAM, prices for less powerful units such as type 256K DRAM should experience some upward pressure.

● **Steel:** Even with marginal prospects of demand growth, U.S. steel production can remain profitable with continued efforts to modernize, hold the line on costs and increase efficiency. Overall, steel mill prices are projected to increase to some

Product-by-product price trends into 1990

(Fourth quarter comparisons)

Product	1989	1990
Basic raw materials & energy		
Nonfood, nonfuel for manufacturing	7.8	4.7
Corrugated containers	3.4	3.2
Refined petroleum products	13.0	5.4
Electric power	4.3	2.8
Metals		
Galvanized sheet	4.5	3.1
Rebars	4.8	1.0
Steel carbon plates	1.2	2.1
Steel castings	3.7	2.5
Primary aluminum ingot	0.0	3.2
Domestic copper cathode	−14.1	−0.1
Fine die casting alloy	12.2	0.9
Aluminum plate	8.6	3.8
Magnesium ingot	4.6	3.2
Component parts		
Electronic components	3.8	3.6
Durable components	5.2	4.0
Fasteners	4.3	3.8
Values & fittings	4.0	2.3
Tires	7.1	7.5
Rubber belts	3.0	4.8
Motors & generators	6.3	5.7
Construction materials		
All materials	3.7	4.0
Lumber & wood products	4.9	4.6
Nonferrous wire & cable	0.1	3.2
Concrete products	1.3	3.3
Asphalt roofing	0.6	3.7
Paint	6.9	5.1
Machinery		
Rail equipment	5.3	5.8
Construction machinery	7.2	5.9
Fluid power equipment	5.3	6.5
Material handling equipment	4.7	3.6
Trucks	5.4	4.4

4.9% this year, 3.0% in 1990 and 4.7% in 1991. In one area—stainless—prices could actually edge lower as nickel and other alloying costs fall.

● **Nonferrous metals:** Prices are targeted to decline in the second half of 1989 as key markets such as automobiles and construction soften. But demand should pick up after mid-1990. As such, nonferrous tags eventually regain some of their lost momentum. Upshot: after rising 22.3% last year, the aggregate price average moves up 7.4% in 1989, only 0.1% in 1990 and 5.0% in 1991.

As for individual metals, aluminum ingot by year end will show no change from late 1988 levels. And in 1990 only a 3.2% advance is seen (see table). Copper, on the other hand, will be softer—with prices off 14% from a year ago by 4Q. Little more than a flat pattern is anticipated for the red metal in 1991. As noted above, nickel will also remain soft—with prices by year end off 10% from late 1988 levels.

● **Industrial chemicals:** Prices will peak this year, with a 13.9% increase expected. A slowdown in real economic growth for 1990-91, combined with the advent of additional chemical capacity, result in some dampening of chemical price averages—with escalation rates of 5.7% and 4.5% for 1990 and 1991, respectively.

● **Building materials:** The current lackluster construction outlook won't have too much near term impact. Reason: supported by projects begun earlier, materials producers should enjoy healthy demand for their products for at least another quarter.

But by 1990, the downturn in residential building and the continuation of the prolonged slide in nonresidential construction will begin to affect materials prices, holding the rates of increase to near 4% a year. By 1991, however, the rebound in nonresidential construction, plus some pickup in the residential area, will produce increases in demand, which will support price advances.

No Gloom and doom

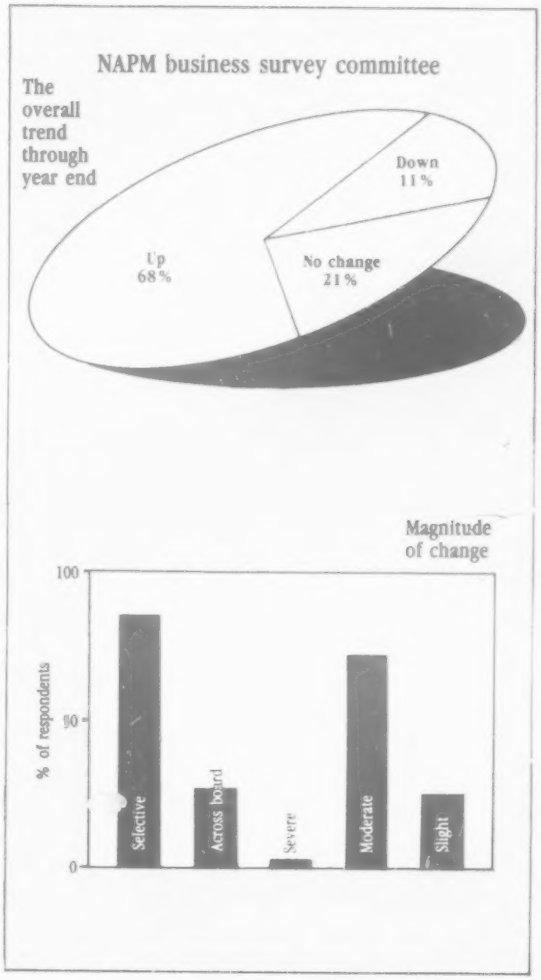
The nation's top industrial purchasing executives aren't buying all the recent gloom and doom talk—either about an upcoming recession or accelerating inflationary pressures.

The evidence comes from two sources: the NAPM business survey committee and *Purchasing World's* own readers. The general feeling in a nutshell is that business gains, while harder to come by, are still anticipated, not only through year end but into early 1990 as well.

And while price increases aren't about to disappear, the horrendous acceleration noted in some areas—most notably in basic raw materials—is over. A fair number of respondents sees the possibility of decelerating annual increases in the quarters immediately ahead.

Taking off on the latter point, the NAPM results on prices (see chart) suggest some improvement in the overall inflationary climate. Specifically, while more than two out of three queried NAPM members still see increases over the remainder of 1989, the magnitude of the advances is expected to slow.

More to the point, only 1% say boosts will be severe over the next six months. (*versus* 6% at the beginning of 1989 when a similar question was posed). And 86% now feel hikes will be selective rather than across the board (*versus* only 72% at the beginning of 1989).



The NAPM estimate of the average increase for 1989 as a whole is also quite encouraging—3.8% currently, virtually unchanged from the 3.7% estimate made at the beginning of 1989. It also means that much of the year's increase may already be behind us—since prices have already advanced by close to 3%.

The *PW* survey tells much the same story. True, the average 1989 increase (roughly 4.5%) is a bit higher than that seen by the NAPM. But no respondent anticipates dou—

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ble-digit jumps. Equally important, the number who have downgraded their 1989 estimates since the beginning of the year now balances out the number who feel bigger hikes may be in the offing. In short, if acceleration is occurring, our average reader is not experiencing it.

As noted above, the two independent buyer studies also confirm that few are accepting the recession forecast that has been making the rounds of late. In fact, the 65% of *PW* readers who feel the second half will exceed the first half is more than double the 30% who feel a drop may be in the cards.

The NAPM committee view would seem to confirm this appraisal. The comparable figures for the overall second half: 42% predict a better second half than first half, 28% a worse second half with the remaining 30% seeing little change. And the NAPM optimism actually rises in 1Q 1990 when the 32% who see improvement *vis a vis* 4Q 1989 is far above the 15% predicting a fall off.

Inventories, examined only by *PW*, look to be rising a bit from now through year end. But put in the context of still-improving business conditions, this suggests that the gains will do little more than keep pace with production. Implication: the inventory/sales ratio (essentially a measure of days' supply) will stay pretty much near current low levels.

Looking next at exports--something which only NAPM examines: about 46% see increases over the next half year—overwhelming the 7% which anticipated declines. True, the ratio isn't quite as lopsided as the 57% up and only 4% down reading of six months earlier. But it still has to be regarded as a major plus sign of the economy.

These same NAPM buyers also see a step up in capital expenditures for the year as a whole--45% anticipating increases *versus* only 24% anticipating decreases. This has hardly changed from beginning-of-the-year estimates—something indicating that the capital equipment boom first noted last year still has a ways to go.

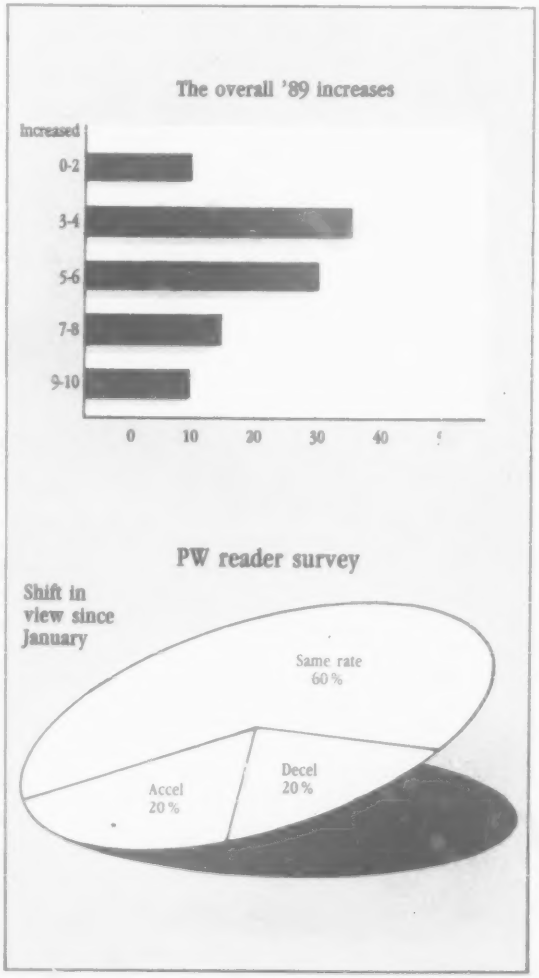
And, it's easy to see why—for 54% of NAPM respondents say their firms are operating at 90% or higher utilization levels. On the other hand, there are signs that the capital spending is having some effect—because an even bigger 58% were producing in the 90% or higher operating rate range at the beginning of the year.

This trend toward better market balance could also be why *PW* readers expect better supply/demand balance ahead. Specifically, some seven out of every ten see no major shortages. True, 25% do feel some further leadtime stretchouts are still possible. But this is now being offset by another 25% who are hopeful they can narrow leads

That's not to say that these same readers don't have a few supply problems—most notably in bearings and selected chemicals, and in a few memory device areas. But they add that in the last two categories things look like they're ready to ease a bit.

The nation's purchasing managers are also leaving no stone unturned in their own drives to keep inflation within bounds. Some of their approaches: better inventory controls, cost justification for all important price increases, more long-term contracts and blanket orders (often with price guarantees), closer liaison with vendors (not only to get better prices but to improve quality and delivery performance), more value analysis and even some nedging on future markets.

The situation is perhaps best summed up by one respondent who observed, "I think buyers, suppliers and the Fed are now all pulling in the same direction. And while the inflation threat isn't going to disappear any time soon, we're betting we can knock about one percentage point off our overall inflation rate—if not by year end then certainly by next spring or summer."



Econometric models make corrections

The big econometric forecasting models are making some midyear corrections—covering both 1989 and 1990 projections.

Generally speaking, this year's growth estimate has been raised fractionally—an increase that is more than being compensated for by smaller-than-previously-forecast business gains.

And in the price sector, this year's estimates have been raised somewhat—though a falloff to near previously forecast levels is foreseen for 1990.

Talks with analysts of the three models monitored semiannually by *PurchasingWorld* suggest that few are worried about any significant downturn.

To be sure, their estimates for next year aren't all that robust—1.4% as far as real GNP is concerned (*versus* the 2.0% estimate made in January) and only 1.0% for industrial production (*versus* the 2.2% earlier estimate). But the feeling is that this is all to the good.

The shift in the price climate will also be helped by expectations of leveling energy tags and a normal harvest which should put a lid on food costs. In any event, it should be noted that all three price indexes presented in the table alongside are now expected to sport decelerating advances in 1990.

In the case of the GNP price deflator and the consumer price index (both heavily weighted with inflation-prone services), 1990s price relief will be fractional. More to the point: These bellwether inflation indexes are expected to drop only about 0.2-0.3 percentage points—with 1990 average rates of advance put at 4.5% for the GNP deflator and 4.9% for the CPI.

On a somewhat more optimistic note is the forecast for finished producer prices—an area of more immediate concern to industrial purchasing managers. Here the decline in the rate of advance is put at over one and a half percentage points—from 5.4% in 1989 to only 3.7% in 1990.

Talks with spokesmen for the models indicate that several factors should be operative in bringing down the rate of advance in finished producer prices. Thus in addition to the aforementioned leveling off in both energy and operating rates, there is today's somewhat stronger dollar (which should keep a lid on import prices) and higher unemployment levels which will hopefully temper labor demands for big pay boosts.

On the unemployment front the consensus economic forecast calls for a 5.9% jobless rate in 1990—a not insignificant jump over the 5.4% level anticipated for 1989. And this could be why unit labor cost forecasts made by these same models (not shown in the table) also remain in the modest range.

Another change from the previous forecast worth commenting on: interest rates should begin to turn down—as the economy slows and inflationary pressures ease off. The latest estimate here calls for only a 10.2% prime rate for 1990—more than one percentage point under this year's estimated level.

What makes all these projections so impressive is that there is very little disagreement among the forecasting models examined. All three see deceleration in GNP and industrial production, all three see no recession and all three call for declines in both finished producer price increases and interest rates.

Also worth noting: these forecasts have experienced pretty good track records of late—particularly on the inflation front. Last July, the consensus forecast for 1988 called for a 2.4% increase in finished goods prices. The actual increase: 2.5%. Similarly, the average 4.0% forecast for consumer tags ended up at an almost identical 4.1%.

Finally, it should be emphasized that these same models remain bullish about 1991. Preliminary forecasts put GNP growth that year at near 3%, the ninth straight year of economic gain.

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What the econometric models see through 1990

	1989	1990
Real GNP (% change)		
DRI	2.6	1.4
Wharton	2.9	1.7
Merrill Lynch	2.6	1.2
AVERAGE	2.7	1.4
Industrial production (% change)		
DRI	2.9	1.4
Wharton	3.3	1.6
Merrill Lynch	3.2	0.0
AVERAGE	3.1	1.0
GNP price deflator (% change)		
DRI	4.5	4.2
Wharton	4.8	4.4
Merrill Lynch	4.9	4.9
AVERAGE	4.7	4.5
Finished producer prices (% change)		
DRI	5.5	4.5
Wharton	4.9	2.1
Merrill Lynch	5.9	4.4
AVERAGE	5.4	3.7
Consumer prices (% change)		
DRI	4.9	4.7
Wharton	5.3	4.7
Merrill Lynch	5.5	5.2
AVERAGE	5.2	4.9
Prime interest rate (%)		
DRI	11.3	9.4
Wharton	12.0	11.3
Merrill Lynch	10.9	9.8
AVERAGE	11.4	10.2
Unemployment rate (%)		
DRI	5.4	5.9
Wharton	5.4	6.0
Merrill Lynch	5.4	5.9
AVERAGE	5.4	5.9

Transport prices cool down

Transportation rate increases should stay in the tolerable range this year—with the average freight bill rising about 4%—actually a half a percentage point under last year's advance.

So say analysts at Wharton Econometric Forecasting Associates in their quarterly transportation rundown prepared especially for *PurchasingWorld* readers. WEFA isn't too worried about 1990 or 1991 either, anticipating only a modest overall acceleration in the rate of rise (to 4.6% and 5.0%, respectively).

Also on an upbeat note for transportation buyers: The latest estimates for both 1990 and 1991 are a bit under the 5.3% forecast made for these two years just three months earlier (*PW*, 3/89, page 32).

The Bala Cynwyd, PA-based consulting firm says the price downgrading stems from a change in thinking about overall economic growth. Specifically, business gains are expected to be somewhat harder to come by in the quarters immediately ahead.

No recession is forecast, but the 0.5-1.0% rate of GNP advance in some near-term quarters is expected to limit the real freight traffic advance (to only a 2% rate this year and 1.4% in 1990.). This, in turn, should reduce the upward pressure on freight rates.

Here's a more detailed rundown on what WEFA sees for each of the major freight modes:

● **Trucking:** Strong demand last year (tonnage was up 8.2%)—along with hikes in truck user fees, and fuel taxes on the state level and rising wage rates in an increasingly tight labor market for drivers—pushed truck freight rates up by an average of 4.5% for the year as a whole. And these same price pressures persist—plus an additional concern about an expected boost in the Federal tax on fuel.

Nevertheless, little acceleration in price rise is expected. Rate hikes should hit 5.0% this year, 4.7% in 1990, and 5.0% in 1991.

● **Rail:** The industry is coming off a good 1988 when revenue ton miles rose 5.2%. But prices for that year are estimated to have gone up only 3.4%—in part because of intermodal competition from trucking.

Future rail hikes will be a bit higher, but no major acceleration is in sight. Competition will continue to be a factor—and it could also prove to be a powerful tool in labor negotiations (a recent CSX agreement to reduce train crews to three could spread quickly to other carriers).

Another possible moderating factor: the productivity adjustment incorporated by the ICC for use in its Rail Cost Adjustment Factor (RCAF) used to determine permissible rate hikes. The adjustment will reduce the RCAF whenever productivity grows. Best bets for rate hikes then: Up 5.2% this year and 5.0-5.1% over the ensuing two years.

● **Air cargo:** Some tailing off in tonnage gains (last year's domestic and international totals rose 16.4% and 20.5%, respectively) is anticipated. On the other hand, increases will still be above the all-freight average—thanks to still increasing use of just-in-time inventory management and another relatively strong export year.

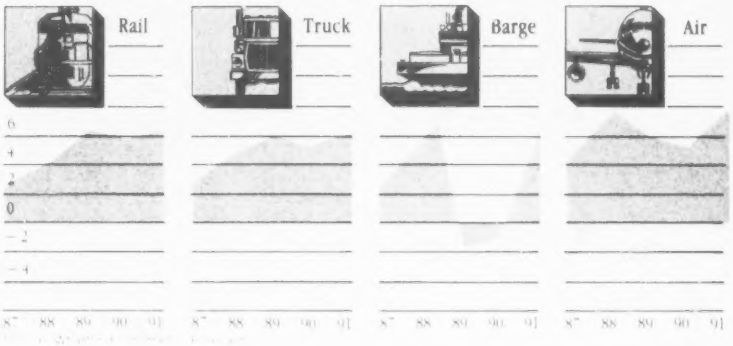
Price increases, too, will be somewhat smaller—about 5.0% this year *versus* 6.4% in 1988.

● **Water freight:** A sizable correction from last year's big 6.2% drought-inspired rate boost is all but certain. Assuming normal precipitation, rates (expected to decline 2.9% this year) should drop back to normal.

Beyond 1989 look for a slow rise—through only a small 2.8% increase is seen for 1990 (a reflection of the lingering impact of the rate correction just now getting underway). But by 1991, a fairly robust 4.9% advance is seen. **PW**

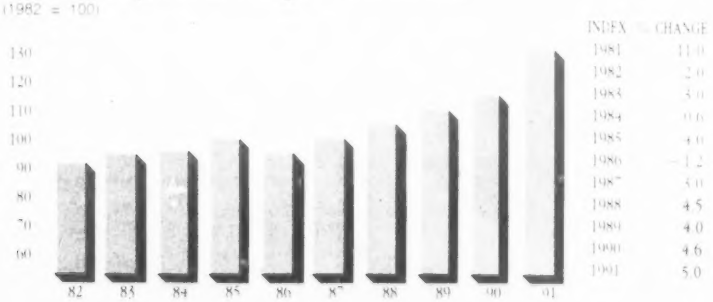
Freight cost outlook by mode

(percent increase over previous year)



PurchasingWorld freight rate index

(1982 = 100)



	INDEX	% CHANGE
1981		11.0
1982		2.0
1983		3.0
1984		0.6
1985		4.0
1986		−1.2
1987		3.0
1988		4.5
1989		4.0
1990		4.6
1991		5.0